The Income Tax Compliance Burden on Canadian Big Business

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Technical Committee on Business Taxation

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Abstract

This report presents the findings from a survey of large Canadian corporations concerning their cost of complying with federal and provincial corporate income and capital taxes. The survey was administered on behalf of the Technical Committee by the Tax Executives Institute during the summer of 1996, and it inquires about the size and composition of these costs as well as the respondents' attitudes and suggestions for reform. An extrapolation based on the survey responses of the non-financial corporate groups in the sample suggests that the combined federal-provincial income and capital tax compliance burden for the top 500 Canadian non-financial corporations in 1995 amounted to $250 million, or about 5 percent of taxes paid. While this burden is considerable, it is appreciably smaller than recent estimates of the compliance cost for large U.S. corporations. A statistical analysis of the major determinants of compliance costs indicates that the compliance burden increases with firm size, but less than proportionately. Compliance costs also tend to be positively associated with foreign operations, and they are substantially larger among corporations in the mining, oil and gas industry.

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1. Introduction

The federal-provincial corporate income tax system imposes costs on businesses beyond the revenue that is collected. In the case of the 500 largest non-financial Canadian corporations, the estimated annual cost of keeping tax records, researching the tax laws, filing returns, responding to audits and launching appeals represents about 5 percent of taxes paid.[1] Ultimately, such costs are borne by individuals in the form of a lower return on their investments, reduced employment compensation and/or higher prices for the products they consume. To assess whether and how the income tax compliance burden can be reduced without compromising other governmental objectives (e.g. without sacrificing revenue or raising administrative costs), it is useful to have reliable information on its nature and underlying causes.

This report presents the findings from a survey of large Canadian corporations concerning their cost of complying with federal and provincial income and capital taxes. Modelled after a broadly similar (but more extensive) survey of large corporations in the U.S. (Slemrod and Blumenthal, 1993), the survey inquires about the size and composition of these costs as well as the respondents' attitudes and suggestions for reform. The remainder of the report is organized as follows. Section 2 provides a brief overview of the Canadian corporate income and capital tax structure. In Section 3, the design and administration of the survey is discussed. This is followed in Section 4 by a summary of the characteristics of the respondent corporations. Section 5 provides a discussion of how the sample of respondents is representative of large corporations in general, and Section 6 summarizes the magnitude and composition of reported compliance costs. In Section 7 a statistical analysis is performed to explain the observed patterns in compliance costs. Then, in Section 8, the respondents' attitudes and suggestions for tax reform are presented and discussed. Section 9 concludes with a comparison of Canadian and U.S. income tax compliance burdens for large corporations.

2. Overview of Tax Structure

The corporate income tax represents the most significant general tax on businesses in Canada. It is imposed by the federal government as well as each of Canada's 10 provinces and two territories. During the 1993-94 fiscal year, the tax accounted for 5.1 percent of consolidated government revenues.[2] Corporations are subject to a provincial income tax in every province and territory in which they have a permanent establishment. Where businesses are established in multiple jurisdictions, a formula is used to allocate taxable income among them. Consolidated reporting is not permitted in Canada at either the federal or provincial level. Thus, a separate return must be filed for each of a corporation's Canadian subsidiaries. With the exceptions of Alberta, Ontario and Quebec, all provinces and territories rely on the same tax base as the federal government, which collects the taxes on their behalf. The common tax base is similar to

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[1] Taxation also creates economic distortions that impose a further burden on society; however, such costs are beyond the scope of this paper.

[2] Canadian Tax Foundation (1995), p. 4:1.

accounting income with certain notable exceptions.[3] The tax bases in Alberta, Ontario and Quebec, which administer and collect their own corporate income taxes, are broadly similar to the federal base. The basic rate of federal tax on large corporations is 21 percent for manufacturing and processing profits, and 28 percent for other sources of income, plus a surtax amounting to 1.12 percent of income. However, credits or deductions are granted for various qualifying expenditures, such as certain forms of investment, charitable and political contributions, and foreign taxes paid. With the exception of manufacturing and processing profits, which are taxed at a preferential rate in some jurisdictions, the general rate of tax ranges from 9 percent to 17 percent among the provinces and territories.[4] Although the tax bases and, in most cases, the general tax rates are rather similar across jurisdictions, the availability and levels of various credits (such as those for specified investments) do vary substantially.

In addition to corporate income taxes, large corporations also are subject to capital taxes. A tax on the paid-up capital of financial institutions is imposed by the federal government and each of the ten provinces. In addition, a general capital tax is imposed by the federal government and five provinces (British Columbia, Manitoba, Ontario, Quebec and Saskatchewan). The capital income tax rate and base vary from jurisdiction to jurisdiction, and differ according to whether a corporation is financial or non-financial. However, the base for non-financial corporations generally includes share capital, retained earnings, reserves, long-term debt, and short-term debt of a capital nature, less certain allowances (for example, for qualifying investments).

3. Survey Design and Administration

A preliminary draft of the survey was developed in May 1996. The draft was reviewed by a panel consisting of selected members of the Technical Committee on Business Taxation (henceforth, referred to as "the Committee") and other officials from the Department of Finance and Revenue Canada. In addition, it was independently reviewed by the Canadian Income Tax Committee of the Tax Executives Institute, Inc. (TEI). Comments and suggestions for improvements from both groups were incorporated into the final version of the survey.

The final survey instrument was completed in June 1996. The instrument is reproduced in the appendix. It is divided into four parts. Part 1 inquires about the general characteristics of the Canadian corporate group, such as the number of Canadian subsidiaries and other related companies, the numbers and types of returns and certain forms filed, group size, and primary industry. Parts 2 and 3 inquire about the costs of complying with corporate income and capital taxes. Compliance costs are broken down according to source (in-house personnel, in-house non-personnel, and external) and function (keeping records and filing returns; research and planning; and audits, appeals and litigation). Part 4 inquires about the respondents' attitudes and suggestions for reform. The respondents are asked to identify the aspects of the current tax system that are most responsible for the cost of compliance, and to suggest ways to simplify compliance with corporate income and capital taxes. In addition, since an objective of the

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[3] As noted in Canadian Tax Foundation (1995), these exceptions include the treatment of depreciation and the presence of various tax incentives in the form of deductions and credits.
[4] These rates are reported in Canadian Tax Foundation (1995), Table 4.2, p. 4:4.

Committee is to improve the tax system to promote job creation and economic growth, respondents are also asked to provide suggestions for tax system changes (in particular, changes that would be approximately revenue-neutral) in areas outside of the costs of tax compliance.

The survey was administered for the Committee by the Canadian Income Tax Committee of the TEI. The survey was mailed to all of the approximately 250 Canadian TEI members (most of whom rank among the very largest Canadian corporations) on July 2, 1996, along with a cover letter from the Chair of the Canadian Income Tax Committee encouraging participation and emphasizing that individual replies would be kept confidential. Because of the short timeframe faced by the Committee, the cover letter requested that completed surveys be returned by mail or fax by the end of July. The last completed survey was received on August 21. A total of 60 surveys were received, 59 of which were sufficiently complete to be used in the analysis that follows. The response rate is therefore approximately 24 percent, which is within the range of response rates for business compliance burden surveys performed in other countries.[5]

4. Corporate Group Characteristics

Table 1 presents some basic summary statistics on the characteristics of the responding corporate groups. Fourteen of the 59 respondents operate in the financial (including insurance) sector. On average, there are 20.5 members in the corporate group for non-financial businesses and 41.4 for financial businesses. The average number of pages submitted on behalf of the group for the 1995 federal return alone amounted to nearly 2,000 pages for non-financial businesses and nearly double this amount for financial businesses. Moreover, an average of 17.1 (47.7) total provincial returns were filed for non-financial (financial) groups in Alberta, Ontario and Quebec that year. Virtually all corporate groups were subject to the federal capital tax on large corporations (the Large Corporation Tax) and about 71.4 percent of groups in the financial sector were subject to the federal tax on the capital of financial institutions. In addition, all groups were subject to capital taxes in at least one province; on average, a non-financial (financial) group was subjected to capital taxes in 3.8 (6.9) provinces. All financial and nearly all non-financial corporate groups had at least one taxation year open to appeals, litigation or waivers; the average numbers of years open were 7.6 and 11.4 for non-financial and financial groups, respectively. All but one group in the sample completed at least one form T106 (Corporate Information Return of Non-arm's-length Transactions with Non-resident Persons), indicating that they were engaged in multinational operations. On average, about 20 such forms were completed. The non-financial corporate groups in the sample are quite large, averaging 8,568 employees, $2.9 billion in gross receipts, and $3.4 billion in assets. The financial groups are even larger, averaging 13,041 employees, $5.3 billion in gross receipts, and $58.4 billion in assets.

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[5] The response rates for other recent business compliance burden surveys have been: 31% (Sandford and Hasseldine, 1992) for New Zealand, 27.5% (Slemrod and Blumenthal, 1993) for the United States, 24% (Sandford, Godwin, and Hardwick, 1989) for the United Kingdom and 16.9% (Pope, Fayle, and Chen, 1991) for Australia.

5. Representativeness of Sample

In the absence of aggregate statistics on membership characteristics, it is not possible to confirm whether the sample of respondents is representative of the overall Canadian TEI membership. However, given the reasonably high response rate, the working assumption in this study is that the sample is in fact representative of the overall membership.

Nonetheless, while it is valuable to learn about the income tax compliance burden of membership, it is even more important to learn about the compliance burden of Canadian big business overall. To determine how representative the sample is of Canadian big business, sample statistics on 1995 revenues were compared against the revenues of the 1996 FP500, the *Financial Post's* listing of the top 500 Canadian corporations in 1995. Finance and insurance groups in the sample were excluded from this comparison, because such businesses are not accounted for in the FP500.[6] The comparison revealed that the revenues in the sample tend to be clustered among the top of the list of FP500 revenues. For example, 12 of the 42 non-financial groups (28.6 percent) fell within the top decile, and 23 (54.8 percent) fell within the top two deciles. To make the sample of non-financial corporate groups approximately representative of the FP500, a weighting scheme was employed that attached relatively greater weight to the groups with lower revenues in the sample.[7]

In the following Section, both weighted and unweighted statistics on compliance costs are presented. The former results are based only on non-financial corporate groups in the sample and are meant to be representative of the FP500. The latter are based on the entire set of respondents and are meant to be representative of the overall TEI membership.

6. Compliance Costs

Magnitude of Compliance Costs

Table 2 presents the average cost of compliance for federal and provincial corporate income and capital taxes combined, both for the FP500-weighted sample and for the sample of all responding corporate groups. Within the former sample, the average compliance cost amounts to $507,000, implying an aggregate compliance cost for the group of about a quarter billion dollars. This

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[6] The TEI membership includes a small number of privately owned corporations, whereas the FP500 consists only of public corporations. However, it seems reasonable to assume that the compliance burden for large corporations depends more on industry characteristics and other factors than on whether they are publicly owned. In any case, it was not feasible to exclude the few private corporate groups who may have been included in the sample from the comparison, because respondents were not required to identify themselves on the survey. However, three non-financial groups were excluded from the sample, either because they did not report information on gross receipts or because the reported level of gross receipts was below the minimum value for an FP500 corporation. This left 42 non-financial corporate groups for the analysis.

[7] The 42 non-financial corporate groups in the sample were broken into five groups according to whether their revenues fell within the first decile, the second decile, the third decile, the fourth through sixth deciles, or the seventh through tenth deciles of the FP500. Weights were then constructed to make the relative frequency of each group match the relative frequency within the corresponding FP500 group. The respective unweighted sample frequencies for these five groups are 12, 11, 6, 7 and 6, and the corresponding sample weights are .35, .3818, .7, 1.8 and 2.8.

amounts to $120 per full-time equivalent employee or, alternatively, 0.04 percent of gross receipts. Profits averaged $65 million among FP500 corporations in 1995, which implies that the compliance burden represents about 0.8 percent of corporate profits.[8] The FP500 corporations are estimated to have paid an average of $10.3 to $11 million in federal and provincial corporate taxes.[9] This implies a compliance burden of 4.6 to 4.9 percent of taxes paid.

The average compliance cost among all responding corporate groups is over 80 percent larger than the FP500 figure, $925,000, reflecting the fact that the sample contains a disproportionate share of the very largest businesses, including financial corporations. When viewed in relation to size ($97 per full-time equivalent employee or 0.03 percent of gross receipts), the cost is actually somewhat lower than that obtained for the FP500-weighted sample. The cost is also markedly lower in relation to total federal-provincial tax revenues, representing about 2.7 percent of taxes paid compared to 4.6 to 4.9 percent for the FP500-weighted sample.[10]

Composition of Compliance Costs

Table 3 provides a breakdown of compliance costs by source. Within the FP500-weighted sample, in-house personnel expenditures account for 56.9 percent of total compliance costs, while in-house non-personnel expenditures and external assistance account for 20.6 percent and 22.5 percent, respectively. The results for all responding corporate groups are similar, although in-house non-personnel expenditures account for a somewhat larger share of all costs (24.6 percent).

Table 4 provides a breakdown of compliance costs by function. Within the FP500-weighted sample, about 46 percent of all in-house personnel costs is spent on keeping records and filing returns. Another 29 percent is spent on research and planning, and the balance is spent on audits, appeals and litigation. The results are quite similar for all responding corporate groups. Whereas nearly half of all in-house personnel expenditures are for record-keeping and filing returns, only between 6.5 and 9.5 percent of expenditures on external assistance is devoted to this function, depending on which sample is used. Rather, the largest category of expenditures on external assistance is research and planning, followed by audits, appeals and litigation.

Table 5 breaks down total expenditures on a function into the shares spent on internal and external assistance.[11] The lion's share of record-keeping and filing activities is done in-house, whereas a large percentage of both research and planning; and audit, appeals and litigation work is done externally.

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[8] Corporate profits are defined by the *Financial Post* as the after income (or loss) from discontinued operations, taxes and minority interests, but before extraordinary items. The average profit was computed based on the 396 out of 500 corporations for which profit information was available in the FP500 listing.

[9] Estimated federal taxes were computed based on tabulations provided by the Department of Finance for 1993 taxes. The estimated federal revenues were then multiplied by a factor of 1.512 to account for provincial taxes. This factor was computed as the ratio of federal plus provincial to federal corporate tax revenues in 1994-95 as reported in Canadian Tax Foundation (1995).

[10] This statistic was computed using the same procedure described in footnote 9.

[11] These statistics exclude in-house non-personnel expenditures.

7. Determinants of Compliance Costs

In this section, statistical methodology involving regression analysis is employed to identify what aspects of a corporate group and its tax circumstances are most responsible for compliance costs. A regression analysis is first performed for the determinants of overall income tax compliance costs. Next, a regression analysis is undertaken of the factors influencing the shares of overall compliance costs attributed to the in-house personnel, in-house non-personnel and external assistance categories of expenditure. This is followed by a regression analysis of the factors influencing the shares of total compliance costs accounted for by keeping records and filing returns; research and planning; and audits, appeals and litigation. The results presented are based on the FP500-weighted sample. Qualitatively similar results were found using the sample of all responding corporate groups.

Overall Compliance Costs

To identify the determinants of the overall compliance costs associated with federal and provincial corporate income and capital taxes, a multiple regression model was specified using the natural logarithm of total compliance costs (in $ thousands) as the dependent variable. After a specification search, the following explanatory variables were selected:

1) LNT106: the natural logarithm of one plus the number of forms T106 submitted;

2) LNGRSR: the natural logarithm of gross receipts (in $ millions);

3) LNGSZE: the natural logarithm of the number of members in the corporate group; and

4) IND1: a dummy variable for the mining, oil and gas industry category.[12]

It is noteworthy that, other than the mining, oil and gas industry, there was no significant difference in compliance costs across industries after controlling for group size (in terms of the level of gross receipts and the number of members in the corporate group) and number of forms T106. Nor were other factors such as the numbers of provincial corporate income and capital tax returns; the numbers of provincial income tax filings in Alberta, Ontario and Quebec; or the number of open taxation years, significantly related to compliance costs after controlling for these variables.

The results are presented in Table 6. They indicate that a 10 percent increase in the number of forms T106 (signifying a 10 percent increase in non-arm's-length transactions with foreign entities), other factors held constant, increases compliance costs by 2.6 percent. A 10-percent increase in gross receipts, other factors held constant, is associated with a 4.1 percent increase in compliance costs. This is consistent with the stylized fact found for other countries that compliance costs increase with size, but less than proportionately. Similar results were found using asset value or number of employees as alternative measures of group size.

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[12] The specification search involved first estimating a model with an extensive list of potential explanatory variables and then eliminating those variables that were found to be statistically insignificant on the basis of an F-test.

Controlling for size and other factors, mining, oil and gas corporations tend to have substantially higher compliance costs (about 85 percent higher).[13] Finally, a 10-percent increase in the number of members of the corporate group, holding gross receipts constant, results in a 1.8-percent increase in compliance costs. A large portion of this increase may be attributable to the requirement to file separate tax returns for each member of a corporate group.

Cost Shares for Alternative Expenditure Sources

To further explore the determinants of compliance costs, a multiple regression analysis was performed for the cost shares of the three alternative expenditure sources (in-house personnel, in-house non-personnel and external assistance). These shares (measured as decimal fractions times 100) were estimated as linear functions of the following explanatory variables:

1) LNT106: the natural logarithm of one plus the number of forms T106 submitted;

2) LNYRSOPN: the natural log of one plus the number of tax years open due to appeals, litigation or waivers;

3) LNGRSR: the natural logarithm of gross receipts (in $ millions); and

4) IND2: a dummy variable for an industry category of real estate or services.

Other variables, such as dummy variables for other industries, were included in preliminary specifications but were later removed, because they were not found to be statistically significant. The results are reported in Table 7.[14] They indicate that, other factors held constant, in-house personnel expenditures represent a much more important share of compliance costs among real estate and service corporations. Moreover, larger corporate groups expend a much greater share of total resources on in-house personnel than smaller firms. Expenditures on external assistance are positively associated with the number of forms T106 and the number of years open to appeals, litigation or waivers.

Cost Shares for Alternative Expenditure Functions

A multiple regression analysis also was performed to explore the determinants of the shares of compliance expenditures associated with keeping records and filing returns; research and planning; and audits, appeals and litigation.[15] These shares (measured as decimal fractions times 100) were estimated as linear functions of the following explanatory variables:

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[13] The percentage difference in compliance costs between corporate groups in the mining, oil and gas industry category and other groups is computed as the antilog of the coefficient on IND1 minus one.

[14] The regression results embody the restriction that the cost shares for these alternative sources must add to 100 percent. In particular, this restriction implies that the constant terms of the regression must add to 100 and the slope terms to zero. It further implies that the disturbance variance-covariance matrix is singular.

[15] The shares were computed from total compliance costs, excluding in-house non-personnel expenditures.

1) LNPROV: the natural logarithm of the number of provinces in which capital taxes are owed;
2) LNGSZE: the natural logarithm of the number of members in the corporate group;
3) LNT106: the natural logarithm of one plus the number of forms T106 submitted; and
4) IND3: a dummy variable for an industry category of wholesale or retail trade.

Again other variables, such as measures of group size and dummies for other industries, were included in preliminary specifications, but were eliminated because they were not statistically significant. The results are presented in Table 8.[16] They indicate that expenditures on record-keeping activities are relatively less important for wholesale or retail trade corporations, whereas the costs of audits, appeals and litigation are relatively more important. The share of expenditures on audits, appeals and litigation is increasing in the number of provinces in which corporate capital tax is owed and decreasing in the size of the corporate group. The share of resources devoted to research and planning moves in the opposite direction of these changes. Furthermore, the share of total resources devoted to research and planning increases as the number of forms T106 increases. In other words, corporate groups with a large number of foreign subsidiaries tend to engage in relatively more research and planning activities.

8. Attitudes and Suggestions for Reform

The survey contains some open-ended questions about the sources of high compliance costs, ways to reduce these costs, and ways to improve the functioning of the tax system outside the area of compliance costs. This Section summarizes some of the more significant findings from this portion of the survey.[17]

Perceived Sources of High Federal Compliance Costs

Table 9 summarizes the 171 responses to the question: “What aspects of the current tax system are most responsible for the cost of complying with the federal corporate and capital income taxes?” Thirty-nine (22.8 percent) of these responses concern the complexity of legislation. Many of these responses give specific examples of complexity such as interest deductibility rules, the reporting of automobile expenses, loss transfer rules, etc. Many also mention the complexity arising from frequent legislative changes, including retroactive changes.

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[16] As with the analysis of expenditure sources, the regression results for expenditure functions embody the restriction that the cost shares must add to 100 percent.

[17] A comprehensive listing of the responses to the open-ended questions is available on request from the author. In some cases, the responses provided to a question were more appropriate for a different question. In such cases, the responses were reallocated accordingly.

Thirty-four (19.9 percent) of the responses concern the timeliness, quality, and information requirements of audits and appeals. As illustrated in Table 4, audits, appeals, and litigation are reportedly responsible for 21.5 percent of all in-house personnel costs and 31.5 percent of all external costs. It is therefore not surprising that audits and appeals are perceived to be a major source of compliance costs. The primary complaints among the respondents are that audits are too detailed and that cases are not handled in a timely manner. The latter point is underscored by the finding in Table 1 that the average reported number of tax years open due to appeals, litigation, or waivers is 7.6 for non-financial groups and 11.4 for financial ones.

Fifteen (8.8 percent) of the responses concern foreign reporting rules, principally the reporting of non-arms length transactions with foreign affiliates. As discussed in Section 5, all but one of the corporate groups in the sample were required to report such transactions on one or more forms T106; on average, 19.6 such forms were completed. Another 15 responses concern the number of forms and the level of detail required for reporting and paying taxes. A third group of 15 responses focus on deviations from generally accepted accounting practices. Twelve (7.0 percent) of the responses concern multi-jurisdictional tax issues such as the need to file separate provincial returns, and the variations in reporting requirements and procedures across jurisdictions. The issue of multi-jurisdictional taxation is raised again below in the discussion of perceived sources of high provincial tax compliance costs. Other issues receiving numerous comments include: the burden of the Scientific Research and Experimental Development (SR&ED) credit reporting requirements (9 responses); the inability to file a consolidated return for all members of a corporate group (7 responses); fixed asset reconciliation (6 responses); and the burden of having to file not only for the federal income tax but also up to two federal capital taxes (6 responses).

Perceived Sources of High Provincial Compliance Costs

Table 9 also summarizes the 123 responses to the question: "What aspects of the current tax system are most responsible for the cost of complying with provincial corporate income taxes (in the cases of Alberta, Ontario and Quebec) and provincial capital income taxes (in any province you pay them)?" Thirty-seven (30.1 percent) of these responses concern the burden of coping with differing rules and tax bases across jurisdictions. A related issue raised in 21 (17.1 percent) of the responses is the cost of dealing with audits and appeals in multiple jurisdictions. The respondents show particular concern over the degree to which audit activities overlap among the various provinces and the federal government, and the lack of co-ordination among these jurisdictions in their audit procedures. A second related issue raised in 20 (16.3 percent) of the responses is the degree to which reporting efforts must be duplicated due to the separate filing requirements in each jurisdiction and the absence of consolidated returns. As discussed in Section 7, the regression results indicate that the number of members of the corporate group has a strong positive association with the overall level of compliance costs, even after controlling for

group size as measured by the level of gross receipts. This is consistent with the perception among the respondents that the introduction of consolidated returns would significantly reduce the compliance burden.[18]

Some of the responses refer to specific aspects of provincial legislation as major sources of compliance costs, such as Ontario's SR&ED Super Allowance and its corporate minimum tax and Quebec's "Statement of Costs Incurred Respecting Work Carried out on an Immovable." Numerous other concerns are raised in the responses, such as deviations from generally accepted accounting practices, the complexity of provincial legislation, and the problems caused by disagreements among jurisdictions over income allocation.

Proposals to Simplify Tax Compliance

Table 10 summarizes the 184 responses to the question: "What suggestions would you make to simplify compliance with the federal and provincial corporate income and capital taxes?" Fifty-five (29.9 percent) of the responses provide suggestions to harmonize taxes and/or centralize collection. As discussed in Section 4, corporate groups in the sample are subject to capital taxes in a number of different provinces. The overall average number of provinces in which a corporate group pays these taxes is 4.5. Moreover, with one exception, all of the groups in the sample file income tax returns in at least two of the three provinces (Alberta, Ontario and Quebec) that administer their own provincial income tax. It is therefore not surprising that so many responses would express concern over the need for harmonization and central tax collection.

Other proposals receiving numerous requests include: the reduction or elimination of certain information reporting requirements (29 requests); harmonizing and/or otherwise improving the audit and appeals process (28 requests); introducing consolidated reporting (17 requests); relying more heavily on accounting rules (10 requests); eliminating capital taxes (9 requests); abolishing special incentives (9 requests); and maintaining continuity in tax legislation – especially avoiding retroactive changes (9 requests). Rather than simplifying the existing system, six respondents suggested scrapping the system altogether and replacing it with an alternative system, such as a consumption tax.

The survey also inquires whether the proposed simplifications would result in the respondents paying more or less tax. The majority (69.2 percent) feel that their proposed changes, on net, would be revenue neutral. Only 3.9 percent believe that their taxes would increase as a result of

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[18] Unfortunately, it is not possible to precisely estimate the average burden reduction associated with the introduction of consolidated reporting. However, a very rough upper bound for the average reduction can be estimated from the regression results presented in Table 6 as the difference between the average predicted compliance cost using the actual corporate group size and the average predicted cost when the group size is reduced to one. The estimated upper bound based on this approach amounts to an average savings of approximately $182,000 per FP500 corporation or 37 percent of total compliance costs. However, this estimate is likely to substantially overstate the actual cost savings associated with consolidated reporting. A reduction of corporate group size down to one would involve not only a cost savings from having to file many fewer returns, but also a substantial reduction in tax-related accounting costs from having to report on the operations of many fewer group members. Only the former type of cost savings would be achieved through consolidated reporting alone.

their proposals, whereas 11.5 percent feel that their taxes would be reduced, and the remaining 15.4 percent are unsure. When asked whether they would be willing to accept simplifications along the lines suggested, if it meant paying more tax, only four of the 55 respondents gave an unqualified "yes." Another 15 said they would accept a tax increase only if they were better off after taking into account their reduction in compliance costs, and seven others said they would go along, only if various other specified conditions were satisfied. Twenty-two of the 55 respondents said they would not accept any additional taxes, with six emphasizing their opposition with an exclamation point or other expression of strong objection. Seven respondents did not state whether they would be willing to accept a tax increase, but commented either that their specific proposals would not require an increase in taxes, or that tax simplification in general should not require one.

Proposed Tax System Changes Outside Compliance Costs

Table 10 also summarizes the 56 responses to the question: "An objective of the committee is to improve the tax system to promote job creation and economic growth. Bearing in mind that the committee is searching for improvements that are approximately revenue-neutral, do you have any suggestions for tax system changes in areas other than the costs of compliance?" Three of the respondents suggest that the tax system should not be used as a vehicle for promoting job creation or economic growth. However, the majority offer a variety of both general and specific suggestions for modifying the tax system to better accomplish these objectives. Some of the more popular suggestions include reducing corporate tax rates (8 responses), abolishing payroll taxes (5 responses), and harmonizing the federal and provincial sales taxes (5 responses).

9. Comparison to Results for Big Business in the United States

Although there have been a number of valuable studies of corporate tax burdens in other countries, virtually all of them have focussed on small or medium sized businesses.[19] The results of these studies, therefore, are not comparable to those obtained in this study. However, Slemrod and Blumenthal (1993) recently conducted a comparable survey of the income tax compliance costs of big business in the United States.

The estimated average compliance costs for the overall sample of 365 corporations studied by Slemrod and Blumenthal amounts to US$1.6 million ($2.1 million for their Fortune 500 sample) in 1990. This is substantially larger than the approximately C$925,000 in average compliance costs for the sample of Canadian corporate groups in 1995 ($507,000 for the FP500-weighted sample). Part of this difference may be attributable to the larger relative size of the sampled U.S. businesses. For example, the average number of employees in the U.S. sample was 12,548, compared to 9,579 for the overall Canadian sample. As the regression results in Section 7 clearly indicate, compliance costs tend to increase with corporate group size, although less than proportionately. However, even when the overall U.S. burden is taken in terms of cost per employee (US$125) or as a percentage of taxes paid (3.2 percent) it amounts to considerably

[19] See, for example, Pope, Fayle and Chen (1992) for Australia; Sandford and Hasseldine (1992) for New Zealand; and Sandford, Godwin and Hardwick (1989) for the United Kingdom.

more than the overall Canadian burden (C$97 and 2.7 percent, respectively). Since the ratio of burden to size tends to fall with increasing size, it is striking that this measure is actually higher for the U.S. sample, which contains corporations that are large relative to those in the Canadian sample. Thus, while the income tax compliance burden of Canadian big business certainly is not low in absolute terms, it is apparently low relative to the U.S. experience. The sources of the discrepancy in compliance burdens among large Canadian and U.S. corporations may be attributed to differences in the corporate income tax structures in the two countries. Potential causes of relatively higher U.S. compliance costs include the following: the relatively more complex U.S. depreciation rules; the U.S. federal alternative minimum tax (however, the Canadian federal and provincial capital taxes serve a role similar to the U.S. alternative minimum tax, and are believed to contribute to overall Canadian compliance costs); complexity in the reporting of the U.S. foreign tax credit; the larger number of U.S. jurisdictions in which corporate taxes must be paid; the lack of centralized collection agreements between the U.S. federal and state governments; and the relatively greater variability in reporting and income-apportionment rules across U.S. jurisdictions. On the other hand, U.S. corporations are allowed to file a consolidated return, which presumably works to lessen the gap in compliance burdens between Canadian and U.S. businesses.

Although the U.S. income tax burden on large corporations appears to be larger than the Canadian burden, even after controlling for group size, compliance cost patterns are similar in the two countries. For example, the distribution of compliance costs by source (internal personnel, internal non-personnel and external) for the U.S. sample is rather comparable to that found in this study, although the Canadian sample spends a somewhat smaller share of total costs on external assistance and a somewhat larger share on internal non-personnel items. The distribution of compliance costs by function (keeping records and filing returns; research and planning; and audits, appeals and litigation) also is broadly similar among the two countries. Further, like the Canadian results, the mining, oil and gas industry in the United States also appears to have dramatically higher compliance costs even after controlling for business size and other factors.

Clearly, more research is needed to fully understand and, where possible, eliminate the sources of high corporate income tax compliance costs. However, this study has taken a useful first step by quantifying the magnitude of the income tax burden on large Canadian corporations, summarizing its patterns, and analysing some of its key determinants.

Table 1
Characteristics of Respondent Firms

Characteristic	Non-financial Firms: Sample Statistic	Non-financial Firms: # Firms Responding	Financial Firms: Sample Statistic	Financial Firms: # Firms Responding
Avg. Corporate Group Size	20.5	45	41.4	14
Avg. # Pages for All Federal Returns	1,992	45	3,951	14
Average # Prov. Inc. Tx. Rets.	17.1	45	47.7	14
% Paying Cap. Tx. on Lg. Corps.	97.8%	45	100.0%	14
% Paying Tx. on Cap. of Fin. Inst.	2.2%	45	71.4%	14
% Subject to any Prov. Cap. Tx.	100.0%	45	100.0%	14
Avg. # of Provinces Paid Cap. Tx.	3.8	45	6.9	14
% With Any Open Tax Years	93.3%	45	100.0%	14
Avg. # Open Tax Years	7.6	45	11.4	14
% Filing any Forms T106	97.8%	45	100.0%	14
Avg. # Forms T106 Filed	18.9	44	21.9	14
Avg. # Employees (Full-time Eqv.)	8,568	45	13,041	13
Avg. Gross Receipts ($ million)	$2,886	43	$5,255	14
Avg. Book Value of Assets ($ million)	$3,449	42	$58,438	14

Note: Financial includes firms reporting themselves in the finance or insurance sectors.

Table 2
Average Total Compliance Cost

Sample	Average Total Cost	Sample Size
FP500	$506,968	42
All Respondents	$925,112	58

Table 3
Percentage Frequency of Compliance Costs by Source

Source	FP500	All Respondents
In-house Personnel	56.9%	55.1%
In-house Non-Personnel	20.6%	24.6%
External	22.5%	20.3%
Total	100.0%	100.0%

Table 4
Percentage Frequency of Compliance Costs by Function

	In-house Personnel Costs		External Costs	
Fonction	**FP500**	**All Respondents**	**FP500**	**All Respondents**
Keeping Records and Filing	46.4%	46.3%	9.5%	6.5%
Research and Planning	28.6%	32.2%	52.9%	62.0%
Audits, Appeals and Litigation	25.0%	21.5%	37.6%	31.5%
Total	100.0%	21.5%	100.0%	100.0%

Table 5
Functional Expenditures by Internal and External Costs

	FP500			All Respondents		
Function	**Pct. Internal**	**Pct. External**	**Total**	**Pct. Internal**	**Pct. External**	**Total**
Keeping Records and Filing Returns	92.5%	7.5%	100.0%	95.0%	5.0%	100.0%
Research and Planning	57.8%	42.2%	100.0%	58.2%	41.8%	100.0%
Audits, Appeals and Litigation	62.7%	37.3%	100.0%	64.5%	35.5%	100.0%

Note: Expenditures exclude in-house non-personnel costs.

Table 6
Determinants of Total Compliance Costs

Variable		**Parameter Estimate**	**t-Statistic**
INTERCEPT		2.081	3.641
LNT106		0.258	2.617
LNGRSR		0.410	4.668
LNGSZE		0.179	2.247
IND1		0.616	2.739
Sample size	41		
R-square	0.626		

Table 7
Cost Shares for Alternative Expenditure Sources

Variable	In-house Personnel	In-house Non-personnel	External Assistance
INTERCEPT	41.761	16.098	42.141
	(2.944)	(1.374)	(3.092)
LNT106	-2.827	-2.604	5.431
	(-1.079)	(-1.203)	(2.157)
LNYRSOPN	-9.837	-0.027	9.864
	(-3.340)	(-0.011)	(3.486)
LNGRSR	5.880	1.632	-7.512
	(2.614)	(0.879)	(-3.476)
IND2	20.616	-10.357	-10.258
	(2.043)	(-1.243)	(-1.058)
Sample size	41	41	41
R-square	0.2045	0.0931	0.271

Note: t-statistics are in parentheses.

Table 8
Cost Shares for Alternative Expenditure Functions

Variable	Keeping Records & Filing Returns	Research & Planning	Audits, Appeals & Litigation
INTERCEPT	48.321	30.849	20.829
	(8.197)	(5.617)	(3.957)
LNPROV	1.203	-8.810	7.607
	(0.374)	(-2.941)	(2.650)
LNGSZE	0.254	1.356	-1.610
	(0.211)	(1.210)	(-1.499)
LNT106	-4.441	3.969	0.472
	(-2.606)	(2.499)	(0.310)
IND3	-6.322	-10.654	16.976
	(-1.352)	(-2.446)	(4.066)
Sample size	41	41	41
R-square	0.141	0.242	0.327

Note: t-statistics are in parentheses.

Table 9
Perceived Sources of High Federal and Provincial Compliance Costs

Source	Number of Responses Listing Source
Perceived sources of high federal compliance costs:	
Complexity of legislation	39
Audits and appeals process	34
Foreign reporting rules	15
NUMBER OF FORMS/LEVEL OF DETAIL REQUIRED	15
Deviations from accounting rules	15
The need to file with multiple jurisdictions	12
SR&ED CREDIT-REPORTING REQUIREMENTS	9
Non-consolidated reporting	7
FIXED-ASSET RECONCILIATION	6
Capital tax-filing requirements	6
Other	13
Perceived sources of high provincial compliance costs:	
Differing rules and tax bases across jurisdictions	37
Audits by multiple jurisdictions	21
Absence of consolidated reporting/multi-jurisdictional filings	20
Other	45

Table 10
Proposals to Improve Tax System

Proposal	Number of Responses Making Proposals
Proposals to reduce compliance costs:	
Harmonize taxes/centralize collection	55
Simplify reporting requirements	29
Harmonize and/or improve audit and appeals process	28
Permit consolidated reporting	17
Rely more heavily on accounting conventions	10
Eliminate capital taxes	9
Abolish special incentives	9
Maintain continuity in tax rules	9
Scrap/replace existing system	6
Other	21
Proposals to improve job creation and promote economic growth:	
Reduce corporate tax rates	8
Abolish payroll taxes	5
Harmonize federal and provincial sales taxes	5
Other	38

Appendix:

Cover Letter and Survey Instrument

Note: The following letter and survey were reproduced for electronic dissemination. The format may differ from the original.

Shell Canada Limited

July 2, 1996

TEI MEMBERS – CANADA

I am sure you are aware that Finance Minister Paul Martin commissioned a "Technical Committee on Business Taxation" in the last Federal Budget. The Committee is chaired by Jack Mintz who addressed our annual conference last May.

Your Canadian Income Tax Committee has been working with Mr. Mintz to develop a Survey of the Compliance Costs of Canadian Federal and Provincial Corporate Revenue and Capital Taxes. We have agreed that it is appropriate for TEI members in Canada to complete the Survey, a copy of which is enclosed.

I think we all agree that the Canadian Income System has become very complex and costly to comply. Anything that can be done to simplify and streamline should be encouraged.

I urge you to complete the questionnaire in as frank a manner as possible. It has been agreed that all replies will be confidential so that it is not necessary to identify your company should you not wish to do so. The Committee has a very short time frame so replies should be sent before the end of July.

Replies can be mailed directly to:

Technical Committee on Business Taxation
c/o Mr. Jack Mintz
Department of Finance
140 O'Connor Street
Ottawa, Ontario
K1A 0G5

If you wish to fax your reply the number is (613) 996-0660. Thanks very much for your cooperation. If you have any questions please feel free to give me a call.

Regards,

J.A. (Drew) Glennie
Chair, Canadian Income Tax Committee
Tax Executives Institute, Inc.

cc: Mr. Jack Mintz – w/o attach.

SURVEY OF THE COMPLIANCE COST OF CANADIAN FEDERAL AND PROVINCIAL CORPORATE INCOME AND CAPITAL TAXES

JUNE 1996

Performed for the Technical Committee on Business Taxation

PART ONE: Characteristics of the Corporation

For questions 1 through 7, refer to tax year 1994 returns, or if already completed, tax year 1995 returns.

1. Counting all Canadian subsidiaries and other related Canadian companies, what is the total number of members in the corporate group for which you are reporting? ______________

2. How many pages or centimeters of documents were submitted, in aggregate, as part of the federal returns for all members of your corporate group?

   ___________ pages **or** ___________ centimeters

3. If your group has filed any provincial corporate income tax returns in Alberta, Ontario, or Quebec, please check the appropriate box(es) and indicate the number of returns filed:

   Alberta ☐ Ontario ☐ Quebec ☐

   Number ____ Number ____ Number ____

4. Was your group required to complete any of federal Forms T2147, T2148, T2149, or T2150, Part I.3 Tax Payable ("Tax on Large Corporations")? Yes ☐ No ☐

5. Was your group required to complete federal Form T2044, Part VI Tax Return ("Tax on Capital of Financial Institutions")? Yes ☐ No ☐

6. Was your group required to complete any federal Form T106's (Corporate Information Return of Non-Arm's Length Transactions with Non-Resident Persons") Yes ☐ No ☐

   If Yes: a) How many forms? ________

   b) Approximately how many total employees (full-time equivalents) are employed by your group's foreign affiliates?________

7. Were you required to pay any provincial corporate capital taxes? Yes ☐ No ☐

   If Yes: a) How many forms? ________

   b) On how many total returns are these taxes reported?________

8. Please indicate which **one** of the following industry categories best describes the activities of your primary business:

Agriculture, Fishing, Trapping	☐	Wholesale Trade	☐
Forestry	☐	Retail Trade	☐
Mining, Oil, and Gas	☐	Finance	☐
Construction	☐	Insurance	☐
Manufacturing	☐	Real Estate	☐
Transportation and Public Utilities	☐	Services	☐

9. Indices of corporate group size (as of close of 1995, or ___________)

   a) What was the approximate total number of employees (full-time equivalents) in your group? ___________

   b) What was the approximate book value of your group's total assets? ___________

   c) What were your group's approximate gross receipts for the preceding 12 month period? ___________

10. Are any taxation years still open due to appeals, litigation, or waivers? Yes ☐ No ☐

    If yes, how many? _________

PART TWO: In-House Compliance Costs

1. Please estimate your annual budget for salaries (including fringe benefits) for federal and provincial corporate income and capital tax-related work done **in-house** (both within your corporate group's tax department(s) and in other departments). In other words, approximately how many dollars in salaries would be saved if these taxes were eliminated?

   Estimated amount: ___________

2. The tasks involved in complying with federal and provincial corporate income and capital tax requirements fall roughly into the following three categories:

   a) **Keeping records and filing returns:** Saving, creating, and filing necessary receipts and records; setting up and maintaining tax accounting systems; collecting forms and materials; reconciling book and tax accounts; preparing special schedules, attachments, and worksheets; preparing information for financial statements; assembling, copying, and mailing documents; etc.

   b) **Research and planning:** Reviewing tax agency publications or commercially prepared materials; attending classes or seminars; choosing accounting and inventory valuation methods, the nature of the tax year, and the types of forms to file; evaluating the tax consequences of various activities such as hiring and fringe benefit decisions, mergers and acquisitions, liquidations, dividends, raising capital, entering or exiting a market, or engaging in particular forms of expenditure; etc.

c) **Audits, appeals, and litigation**

Please estimate the percentage of total **in-house** personnel expenditures devoted to each of these tasks:

	Percentage of Total
a) Keeping records and filing returns	________
b) Research and planning	________
c) Audits, appeals, and litigation	________
TOTAL	**100%**

3. Please estimate your total annual **in-house** non-personnel costs for complying with federal and provincial corporate income and capital tax requirements (including computer/data processing, record storage and retrieval, office space, supplies, copies, faxes, travel, etc.).

   Estimated amount: ____________

PART THREE: Outside Expenditures on Tax Assistance

1. Please estimate your expenditure on **outside** tax assistance relating to federal and provincial corporate income and capital taxes?

   Estimated amount: ____________

2. Please estimate the percentage of your total expenditures on **outside** tax assistance accounted for by the following tasks:

	Percentage of Total
a) Keeping records and filing returns	________
b) Research and planning	________
c) Audits, appeals, and litigation	________
TOTAL	**100%**

PART FOUR: Attitudes and Suggestions for Reform

1. What aspects of the current tax system are most responsible for the cost of complying with the federal corporate and capital income taxes?

2. What aspects of the current tax system are most responsible for the cost of complying with provincial corporate income taxes (in the cases of Alberta, Ontario, and Quebec) and provincial capital income taxes (in any province you pay them)?

3. What suggestions would you make to simplify compliance with the federal and provincial corporate income and capital taxes?

   - Would the suggested simplifications result in your paying more or less tax?

   - Would you be willing to accept simplifications along the lines suggested if it meant paying more tax?

4. An objective of the Committee is to improve the tax system to promote job creation and economic growth. Bearing in mind that the Committee is searching for improvements that are approximately revenue-neutral, do you have any suggestions for tax system changes in areas other than the costs of compliance?

References

Pope, J., R. Fayle, and D.-L. Chen. (1991) *The Compliance Costs of Public Companies' Income Taxation in Australia, 1986/1987.* Sydney: Australian Tax Research Foundation.

Sandford, C., M. Godwin, and P. Hardwick. (1989) *Administrative and Compliance Costs of Taxation.* Bath, U.K.: Fiscal Publications.

Sandford, C., and J. Hasseldine. (1992) "The Compliance Costs of Business Taxes in New Zealand," Mimeo, Institute of Policy Studies, Victoria University of Wellington.

Slemrod, J., and M. Blumenthal. (1993) "The Income Tax Compliance Cost of Big Business," Working Paper 93-11, the University of Michigan School of Business Administration.

Note: This paper was commissioned by the Technical Committee on Business Taxation. I am grateful to the members of the committee, the Department of Finance, and Revenue Canada for helpful suggestions, particularly Jack Mintz, John Sargent, Paul Lynch, Robert Morrison and Marc Vanasse. I am also indebted to Marsha Blumenthal, Cedric Sandford and François Vaillancourt for their many useful comments on an earlier draft. Finally, I wish to thank Drew Glennie and the Tax Executives Institute for administering the survey, and the respondents for participating.

Technical Committee on Business Taxation

The Technical Committee was established by the Minister of Finance, at the time of the March 1996 federal budget, to consider ways of:

- improving the business tax system to promote job creation and economic growth,
- simplifying the taxation of businesses to facilitate compliance and administration, and
- enhancing fairness to ensure that all businesses share the cost of providing government services.

The Technical Committee will report before the end of 1997; consultations with the public will follow the release of the report.

The Technical Committee is composed of a panel with legal, accounting and economic expertise in the tax field. The members are:

Mr. Robert Brown
Price Waterhouse
Toronto, Ontario

Mr. James Cowan
Stewart McKelvey Stirling Scales
Halifax, Nova Scotia

Mr. Wilfrid Lefebvre
Ogilvy Renault
Montreal, Quebec

Professor Nancy Olewiler
Department of Economics
Simon Fraser University
Burnaby, British Columbia

Mr. Stephen Richardson
Tory, Tory, Deslauriers & Binnington
Toronto, Ontario

Professor Bev Dahlby
Department of Economics
University of Alberta
Edmonton, Alberta

Mr. Allan Lanthier
Ernst & Young
Montreal, Quebec

Professor Jack Mintz (Chair)
Faculty of Management,
University of Toronto (on leave)
Clifford Clark Visiting Economist
Department of Finance
Ottawa, Ontario

Mr. Norm Promislow
Buchwald Asper Gallagher Henteleff
Winnipeg, Manitoba

The Technical Committee has commissioned a number of studies from outside experts to provide analysis of many of the issues being considered as part of its mandate. These studies are being released as working papers to make the analysis available for information and comment. The papers have received only limited evaluation; views expressed are those of the authors and do not necessarily reflect the views of the Technical Committee.

A list of completed research studies follows. They may be requested from:

Distribution Centre
Department of Finance
300 Laurier Avenue West
Ottawa, Ontario K1A 0G5
Telephone: (613) 995-2855
Facsimile: (613) 996-0518

They are also available on the Internet at http://www.fin.gc.ca/

Technical Committee on Business Taxation Completed Research Studies

☐ **WORKING PAPER 96-1**
Comparison and Assessment of the Tax Treatment of Foreign-Source Income in Canada, Australia, France, Germany and the United States
Brian Arnold (Goodman Phillips & Vineberg)
Jinyan Li and *Daniel Sandler* (University of Western Ontario)

☐ **WORKING PAPER 96-2**
Why Tax Corporations?
Richard M. Bird (University of Toronto)

☐ **WORKING PAPER 96-3**
Tax Policy and Job Creation: Specific Employment Incentive Programs
Ben Cherniavsky (Technical Committee Research Analyst)

☐ **WORKING PAPER 96-4**
The Effects of Taxation on U.S. Multinationals and Their Canadian Affiliates
Jason G. Cummins (New York University)

☐ **WORKING PAPER 96-5**
The Integration of Corporate and Personal Taxes in Europe: The Role of Minimum Taxes on Dividend Payments
Michael P. Devereux (Keele University)

☐ **WORKING PAPER 96-6**
International Implications of U.S. Business Tax Reform
Andrew B. Lyon (University of Maryland)

☐ **WORKING PAPER 96-7**
The Economic Effects of Dividend Taxation
Ken J. McKenzie (University of Calgary)
Aileen J. Thompson (Carleton University)

☐ **WORKING PAPER 96-8**
Capital Tax Issues
Peter E. McQuillan and *E. Cal Cochrane* (KPMG, Toronto)

☐ **WORKING PAPER 96-9**
Compliance Issues: Small Business and the Corporate Income Tax System
Plamondon & Associates Inc. (Ottawa)

☐ **WORKING PAPER 96-10**
Study on Transfer Pricing
Robert Turner, C.A. (Ernst & Young, Toronto)

☐ **WORKING PAPER 96-11**
The Interaction of Federal and Provincial Taxes on Businesses
Marianne Vigneault (Bishop's University)
Robin Boadway (Queen's University)

☐ **WORKING PAPER 96-12**
Taxation of Inbound Investment
W.G. Williamson and *R.A. Garland* (Arthur Andersen, Toronto)

Technical Committee on Business Taxation Completed Research Studies *(Cont'd)*

☐ **WORKING PAPER 97-1**
The Sensitivity of the Corporate Income Tax to the Statutory Rate
Peter Dungan, Steve Murphy, Thomas A. Wilson (University of Toronto)

☑ **WORKING PAPER 97-2**
The Income Tax Compliance Burden in Canadian Big Business
Brian Erard (Carleton University)

☐ **WORKING PAPER 97-3**
Taxes, the Cost of Capital, and Investment:
A Comparison of Canada and the United States
Kenneth J. McKenzie (University of Calgary)
Aileen J. Thompson (Carleton University)